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IN THE

Supreme Court of the United States.

OCTOBER TERM, A. D. 1900.

UNITED STATES RUBBER COMPANY, L. CANDEE & CO. and the METROPOLITAN NATIONAL BANK OF CHICAGO

vs.

AMERICAN OAK LEATHER CO., PFISTER & VOGEL LEATHER CO., EAGLE TANNING WORKS et al.

Certiorari to Circuit Court of Appeals, Seventh Circuit.

BRIEF AND ARGUMENT FOR RESPONDENTS,

PFISTER & VOGEL LEATHER CO., EAGLE TANNING WORKS ET AL.

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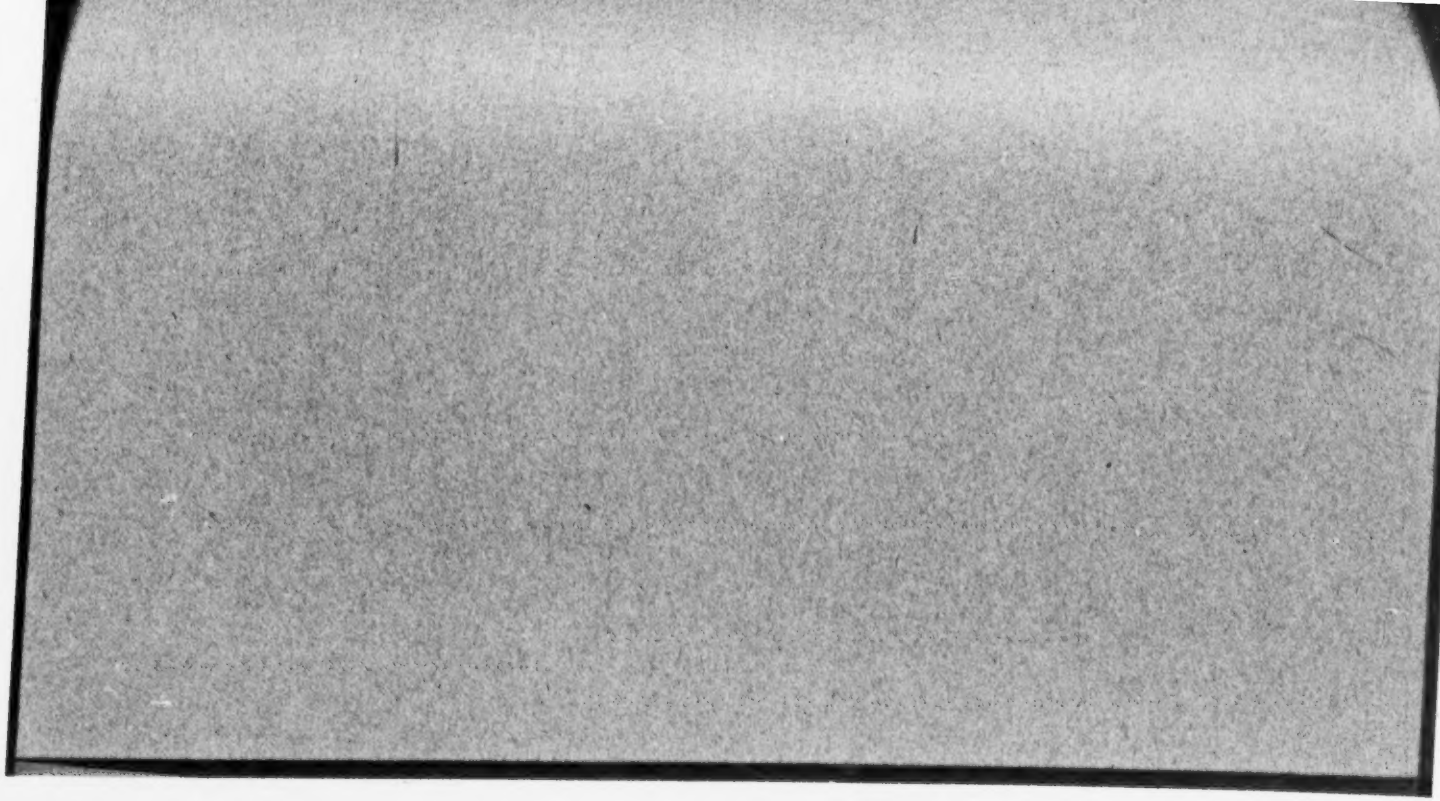

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The respondents represented by us are creditors whose debts were all contracted after the giving of the judgment notes to the petitioners and the making of the arrangement of January, 1896. The goods which they added to the stock of Fargo & Co. were all obtained by the suppression of the secret liens under which the proceeds of those goods are now claimed by petitioners. We therefore think that a separate brief on their behalf, upon the facts of the case having special reference to this feature, will supplement the able argument of our associates, and assist the court in its consideration of the case.

STATEMENT.

Counsel for petitioners have confined their statement of the case to a copy of portions of the master's report. As the Circuit Court of Appeals prepared a statement of the case, to which no direct exception has been taken, we refer to it as presenting the main features of the case upon which we rely. It is contained on pages 717-23 of the record.

The Circuit Court upon final hearing held that the preferences were constructively fraudulent, and decreed an equal distribution of the fund derived from the company's property among all creditors, including the Rubber Companies and the Bank, and placing the Bank's claim at its original amount, disregarding the payment of one-half of it. An appeal from this decree was taken by the Rubber Companies and the Bank and a cross-appeal by the complaining creditors. The Rubber Companies and the Bank assigned as error the action of the court in setting aside their preferences; the complaining creditors assigned as error its action in allowing the preferred creditors to share *pari passu*, and in allowing the Bank's claim at its original amount. The position of the complaining creditors was upheld and their assignments of error sustained. Those assignments of error appear at pages 691-2 of the record.

Having been wholly successful in the Court of Appeals, the complaining creditors ask the affirmance of its decree and the approval of its decision upon the issues involved.

I.

THE PETITIONERS WERE GUILTY OF ACTUAL FRAUD.

Counsel for petitioners (pp. 16-17 of brief) seeks to draw the conclusion that the Circuit Court of Appeals deduced actual fraud, not from the motives and intention of the parties to the January arrangement, but from the supposed injurious effects of the transaction upon other creditors "independent of the actual intention of the parties."

The opinion (Rec., 725-734) of that court, on the contrary, is directed to the discussion of the motives and intention of the parties from almost the beginning to the close. It finds the motives and purpose of all the parties fraudulent at each step, and expresses its general conclusion on the question of actual fraud in the following words:

> "It is clear that the Rubber Companies were guilty of *fraud in fact*, and as against subsequent creditors of the Fargo Company should not be allowed to share in the fund or distribution, and for the reasons stated the Bank likewise should be postponed."

It is obvious, therefore, that by the opinion of that court *results* are made to depend on *actual fraud* and upon *motives*, rather than the reverse, as counsel has stated.

Having thus misapprehended the opinion of the court and the ground upon which it is based, counsel for petitioners proceed to base their argument for a reversal of that judgment upon their erroneous understanding of it. That part of their argument we do not care to follow, for it leads us away from the case in hand into a purely academical discussion of an hypothetical case.

The argument of opposing counsel seems to be based on Napoleon's rule of beating the enemy in detail to prevent the defeat which will result from a contest with his combined forces. They take up some of the separate items of the facts arrayed against them and endeavor to show that each one, considered separately, is not a fraud or evidence of fraud. Their legal argument may fairly be summarized as follows:

1. A corporation has the right to prefer creditors.

2. An agreement to prefer is therefore valid because it obligates the corporation to do only what the law allows.

3. There is no obligation on the part of the corporation, or a secured creditor, to disclose either the fact that a security has been given, or that one has been promised.

4. Therefore the concealment of the security, though it induces others to act to their injury, is not a fraud upon them, or an invasion of any of their rights.

5. That the parties did not intend to have Fargo & Co. increase its purchases of goods for the purpose of getting a *larger* stock for the Rubber Companies to levy on, but only to have it purchase whatever goods were needed. Therefore there was no fraud in their purpose of having all the goods which should be obtained levied upon and of preventing the persons who sold the goods from collecting their pay out of them.

We do not deem it necessary to take up these propositions in detail, nor to go over the authorities relating to them which are collated in the brief of our associates, to which we refer.

The question of actual fraud is argued by opposing

counsel as if it were to be determined by investigating the moral perceptions of those who are responsible for the facts which this record discloses. They reiterate the statement that they had "no *conscious* purpose" of harming creditors; and insist that if their clients were not "conscious" that their "purpose" would necessarily harm those who, by the accomplishment of that very purpose, were induced to deal with the corporation, the law acquits them of any wrong-doing. In short, their contention is, and must be, that the court must accept the estimate which they placed upon their own acts, and cannot exercise an independent judgment unclouded by the effects of self-interest.

In speaking of the purpose which actuated the parties, counsel say that it was merely that of getting a preference, which is recognized as legitimate. This is put forward as being the ultimate object of all that they did, and, as a preference is not an illegal thing, they contend that the means by which they sought to secure it are of secondary importance.

The plan which these parties devised was a somewhat complicated affair, involving a number of details, but its main purpose may be fairly stated in this way. It was to let the company continue in business, concealing the true condition of its affairs in order that creditors should be induced to sell it goods. Obtaining those goods was the essential thing, for without them the company must cease business at once. This, then, was the ultimate object of the whole plan. And if the extremely probable contingency of the company's failure arose, the goods thus obtained were to be applied solely to the payment of the judgment notes by the suppression of which they had been

obtained. The elimination of the possibility of the creditors who sold the goods getting their pay out of them, was an end to which the parties and their counsel devoted all their energy and ingenuity.

The parties implicated in the transaction, in describing its object say that it was "to enable the company to continue in business." But when we consider what they knew this involved, it will be clearly seen that it is but a euphemism by which they concealed—possibly even from their own moral perceptions—the real nature of the transaction. Continuing in business not only necessarily involved, but actually *meant,* buying new goods, and buying them on credit from persons who would have no means of collecting pay for them, except through legal process against the company's assets. We do not mean to say that "continuing in business" implied nothing but *buying* goods; it of course also involved selling them, and keeping up the ordinary incidents of mercantile business. But these were all dependent upon getting goods with which to carry on the business.

That these parties all had this matter of getting goods very clearly in mind as the one of first importance in their scheme is demonstrated by the testimony of each one of them. Indeed, it furnished the sole reason for the secrecy about which they were all so frantically anxious. Absolute secrecy as to their plan was essential only because no goods could be obtained, if the facts became known to those from whom the goods were to be solicited. Their keen appreciation of this obvious fact is shown in Mr. Fargo's testimony, where he says that none of the creditors would have sold the company any goods, or had any dealings with it, if they had known of the January ar-

rangement, and that the effort was therefore to keep it secret. (*Record, pp.* 278-9.)

We must then take it to be an established, and indeed a conceded, fact that the object of the plan was to get goods from other creditors, and to get them by suppressing facts which rendered the corporation utterly unworthy of the credit which was thus to be secured for it.

Passing for the moment the admitted fact that the company's assets at this time were much less than half the amount of its liabilities, and considering only what counsel ask the court to believe these people all thought about its condition, we still have the admitted fact that its *immediate* failure was imminent unless it could borrow money. This fact was not only known to them, but it furnished the very reason for their action. And it is undeniable that knowledge of this fact by persons with whom they dealt, would have prevented the company from obtaining goods, *even if no security whatever had been given to the Rubber Companies.* No business man would have entertained the idea for a moment of selling goods to a corporation which could not pay its existing debts, even if he knew that other creditors would receive no greater dividend than he. It was therefore essential to the success of the scheme that this fact, as well as the preferential securities, be kept secret, so that those whose conduct would be influenced by knowledge of the fact would act upon a false supposition.

There were thus, by the *conceded* facts, three things which were to be suppressed:

1. That the company could not then pay its debts as they matured, and must immediately fail, unless it could borrow money—which, when borrowed, increased both

its debts and assets by the same amount, and thus left its ledger balance the same.

2. That the Rubber Companies had the means of getting a preferential lien at any time.

3. That other creditors were cut off from the possibility of getting security, *even on their own goods*, either superior to or on an equality with the Rubber Companies

In connection with these facts the control which the Rubber Companies had over the corporation has a sinister significance, apart from its legal effect. No argument is needed to show that they had such control, and any attempt to make these directors appear in any light but that of mere tools only serves to make the real fact plainer. This control was not a mere preventive power, a check on the giving of other judgment notes. It went farther than that and included the exercise of all corporate powers. This necessarily resulted from having a majority of the board. The negative exercise of that power by agreeing to let the Fargos run the business without interference from these directors, was but adding to their power to comit frauds on creditors, with the assurance that they would not be prevented. And we have seen with what fraudulent effect the Fargos used this power. But Mr. Beale and his clients contemplated and expected more than that; for they stipulated for five out of the seven directors, so that they would always have the necessary majority for *affirmative action* (*Record, p.* 556). Thus, by the agency which was created with that end in view, they made it possible to accomplish the purpose of getting in goods, and preventing the creditors who sold them from getting their pay.

Now, it is well established that—whatever the parties

may have believed about it—the company was in fact hopelessly insolvent, and that the credit which was secured for it was a credit to which it was not entitled. Keeping up its credit and securing new credit for it, therefore, necessarily involved a deceit as to the actual situation. And the parties who caused the deception admittedly had —to put it most favorably for them—actual knowledge of facts which put them on inquiry as to the company's true condition, the means at hand of ascertaining the truth, and abundant opportunity for investigation. The persons upon whom this "innocent" deception was to be practiced were designedly kept in ignorance of those facts.

If Johnson and Sadler had merely advanced money and agreed to keep silent as to the facts which they knew showing the company's precarious condition, they would have better title to the character of philanthropic benefactors of humanity which counsel claim for them. But their plan did not stop with the "innocent" deception of suppressing insolvency and preferential securities. They bargained for and secured the means of seizing the goods which the deception brought into Fargo's store. And thus they arranged it so that they would win in any event, and placed the hazard of the success of the enterprise solely on those who had been misled, by a false pretense, into selling goods for which they could not get full pay, even were there no preferences; and by the preferences they were to be prevented from getting anything.

We have thus far, in considering this question—if it be a question—of "conscious intent," referred only to admitted facts stated by the parties themselves. And before referring to anything which is the subject of controversy we will call attention to the position which opposing counsel take upon this point.

They say (*brief, p.* 19) that "there was no agreement, discussion or intention that the Fargo Co. should proceed to *increase* its tangible assets." And in support of they quote (*brief, p.* 28) this sentence from the opinion of the Court of Appeals: "It was not, as alleged in the bill, a part of the plan that *increased* purchases should be made for the purpose of *improving* the security of the Rubber Companies." (*Record, p.* 729.) Thus counsel would make the *extent* of a fraud the test of its *existence*. It certainly can make no difference favorable to the Rubber Companies that the resulting injury was not greater. They intended that goods should be bought, and that they should have a lien on those goods to the exclusion of the men who sold them. They secured themselves and put the hazard of insolvency upon the others. It would clearly be a fraud to do this as to one creditor alone; the number of persons to be injured and the extent of their injury affects only the degree and not the quality of the fraud. That the fraud did not go to the full extent which the situation may have rendered possible, is no credit to them; nor does the scheme deserve less condemnation because the parties to it seem, like Warren Hastings, "to wonder at their own moderation." The injury to those who were injured is exactly the same, and it is that injury which calls for redress.

Their desire to get the company on a more conservative basis by reducing its debts, was in line with the furtherance of their own interests in keeping the company going. They had nothing to *gain* by its failure, for all they could collect in any event was the amount of their debts; and they wished it to go on, if possible, because it furnished an outlet for their goods. But they put the chances of its success upon those whom their conduct misled. To claim

for them credit for the fact that they bought less goods than they might have procured, or that they did not increase the stock—when from their standpoint such increase was unnecessary,—is to admit that they actually considered the effect of the scheme on the new creditors, and sought to make its evil consequences as light as possible. It is like saying that there was no fraud in taking the goods of two creditors, if they might have taken those of three.

While it is true that the law sometimes concerns itself with a man's motive or intent, it never concerns itself with his estimate of it. He is presumed to intend the natural result of his deliberate acts, and his liability and culpability are not regarded as lessened because eagerness to attain a particular result, or the blinding effect of self-interest, or a blunted moral sense may have prevented him from appreciating the true nature of either the end which he sought, or the means adopted to reach it. This principle is so elementary that, as Judge Woods most aptly said, "without it a coherent code of law or morals would be impossible." We therefore cannot regard it as important to enter into any discussion of the "consciousness" of these parties of true nature of the "intent" which guided their actions. It is admitted that everything which was done was intentional and a part of a carefully arranged plan. And we find no dispute in counsel's brief over the correctness of the following statement by the Court of Appeals as to the intent of these parties:

> "What did these people intend as to other creditors? Plainly that they should remain or become creditors without security or the possibility of obtaining it, and be at the mercy of themselves, who by a secret control of the corporation were to be able at any hour to close its doors and appropriate all its property to the payment of their own demands."

We have thus far discussed this question upon the facts which petitioners concede, and as though none of the parties doubted the company's solvency. That, however, is a conception of the facts which we submit cannot be accepted.

Take first the knowledge of Fargo upon that question. It cannot be believed that he did not know the real condition of affairs. His own testimony on the subject is most significant. In response to suggestive and leading questions put to him by Mr. Beale he said that he told Johnson and Sadler that he believed the company was solvent; that he believed it had "ample assets to pay all its liabilities in due course of business." What a ridiculous statement this last one was in an interview which was brought about because of the conceded inability of the company to pay its debts "in due course of business." Having testified to this he was asked, "As a matter of fact, Mr. Fargo, you continued to believe the company solvent, did you not, down to about August, or down to about the time of the failure? Ans. Yes, sir." (*Record, pp. 226-7.*) It will be observed that he nowhere denies or suggests that he did not know the amount of the company's assets and liabilities; indeed his examination, as a whole, shows great familiarity with it. And he says that the company did not sustain any losses *which affected its financial condition* between January and August. (*Record, p. 270.*) As he knew the actual facts on which the question of solvency or insolvency depended, we discredit the conclusion which he seeks to draw from them as to his own belief, when to have said the contrary would have been a confession of the most flagrant fraud. And we certainly object to having our clients' rights decided upon his opinion of solvency, when we know that

it was because his company actually was insolvent, according to the well known legal definition, that he asked the Rubber Companies for aid. If he had been in any respect misinformed as to the amount of the company's debts or assets, it would have been an easy matter for him to say so. His failure in this regard, and the failure of the Rubber Companies to offer any evidence to show that he did not know the actual fact is a practical confession. And it is to be remembered that his examination on this point was conducted by Mr. Beale and that none of the other Fargos were placed on the stand.

The view which the Fargos took of the company's condition is well illustrated by the prudent regard which they showed in protecting their own individual interests against the chances of its failure. Prior to January, 1896, they had endorsed the company's notes and at that time such notes to the amount of at least $15,000 were outstanding. These notes were shortly afterwards taken up, with the money obtained from the Rubber Companies, and none of the company's notes were endorsed by them after that time. (*Record, pp.* 214-5.) They thus protected themselves against the hazard of failure, and did not share that hazard with those whom, by direct false statement and suppression of the truth, they induced to furnish goods and money to the company. And when the failure come, through the flimsy pretext of a "loan" from the Bank, they took out $10,000, on the ground, as Fargo says—with a frankness which shows his blunted sensibilities—that "they needed it to live on." Thus we find them at both periods—in January, when it is claimed that they were ignorant of the insolvency, and in August, when it is conceded that they knew it—protecting their personal interests at the expense of the defrauded cred-

itors. Is this a mere coincidence, or does it point to a continuing purpose?

The opinion of the Court of Appeals shows plainly how Johnson and Sadler must have appreciated the true situation of affairs. The very facts laid before them discredited any statement which Fargo might make that his company was solvent. No intelligent man would accept such a statement and act upon it, without inquiry, in an important matter where the means of investigation were right at hand. The conclusion is simply irresistible that they would have done just what they did, if they had examined the books and learned the actual facts which were there recorded. They were making the best bargain they could in a desperate situation, and taking measures which they believed would be effectual against other creditors. In 1893, a time of financial panic, when even solvent houses were in danger, they did not ask security, because they believed the company solvent; and they took judgment notes only because the Bank had exacted them. But they took none of these extraordinary precautions against giving similar securities to other creditors, because they believed the assets sufficient to pay all creditors. Is it possible to believe that two such contrasting lines of conduct were actuated by exactly the same view of the company's solvency? Were these barriers against other creditors, which were unnecessary in 1893 *because* the company's assets were sufficient to pay all creditors, regarded as necessary in 1896, *for the same reason?*

The whole theory of the petitioners' case admits that Fargo and the Rubber Companies were actuated by a common purpose. This is obviously true; for the plan was an entire one, and the intent of one party was no

better than the intent of the other. We consequently find the counsel for the Rubber Companies defending the honesty of Fargo's motives by the same reasoning and evidence which they apply to their own. This is sharply referred to in the opinion of the Court of Appeals, where in speaking of Fargo's confessed deceit of the Pfister & Vogel Leather Co., it says: "His testimony on this point presents an interesting picture of one who, in all this transaction, is credited with having had no wrongful purpose."

If a fraudulent motive on the part of Fargo is shown, there is no theory presented by which that intent can be separated from that of the Rubber Companies, or by which it can fairly be said that Fargo was actuated by one intent and Johnson and Sadler by another. This is well illustrated by the question of the knowledge of the company's condition. It is petitioners' theory that both Fargo and Johnson and Sadler took the same view of the company's condition. This position they are necessarily bound to take; for it could hardly be believed that these men engaged in a common purpose, one actuated by knowledge of the company's insolvency, and the other by a belief in its solvency.

We think it cannot be doubted that the Fargos had knowledge of the company's insolvency, which was too gross to be overlooked; and the studious avoidance of inquiry by Johnson and Sadler shows what they thought investigation might disclose. The established and conceded facts show that the Fargos were guilty from the start of unmitigated fraud. In February, 1896, within a month of the giving of the judgment notes to the Rubber Companies, Frank M. Fargo—who was still held out to the world as the treasurer of the company, though he

had been succeeded by Mr. Beale's clerk—applied to the Dixon banks, with whom the company had not till then had any dealings, for loans. In response to direct inquiries made by the banks' officers he stated that the company had no judgment notes outstanding, that it was prosperous and making money, and that it had a capital of $400,000, and a surplus of $170,000 (*Record, pp.* 308, 311, 313). On the strength of this statement he obtained for the company $17,000.

On April 1st, 1896, Charles E. Fargo made a statement to the mercantile agency of R. G. Dun & Co., giving the items of assets and liabilities, and showing a net surplus of over $416,000. (*Record, pp.* 327-8.) On this statement an extension was obtained from the American Oak Leather Co. of its debt of over $12,000.

On July 22nd, 1896, he stated to Mr. Vogel, of the Pfister & Vogel Leather Co.—from whom he obtained more than $20,000 in goods after the January arrangement was made—that the business was never more prosperous, that the company had two dollars in assets for every dollar of debts, and that no one had any judgment notes or preferences (*Record, p.* 318). It is to be noted that this interview was only two weeks before the failure, and only four days after he and Mr. Beale had been arranging for the entry of judgment on the Rubber Companies' notes if an extension could not be secured of a note of $10,000 held by the Metropolitan National Bank. (*See Mr. Beale's telegrams of July 16 and 17, Record, pp.* 593-4.) The note on which that extension was secured from the Bank matured on the 21st, so that his statements to Mr. Vogel and his arrangements with Mr. Beale to enforce the security given the Rubber Companies were substantially contemporaneous.

It may be true, as stated by Mr. Justice Brown, in his dissenting opinion, that no one was injured by these false statements but the persons to whom they were made. But the cogent force of these facts is, we submit, in no way lessened by that consideration. They simply demonstrate not merely the fraudulent but the iniquitous purpose which actuated the Fargos, and remove all ground for even a pretense of good faith on their part. These fraudulent statements were not made casually, or at any particular time or by one of the Fargos alone. They were direct and deliberate, they covered the whole period from January 6th to the failure, and were made by both of the men who were instrumental in getting up the scheme, of which the suppression of the truth was the essential element.

It is taking a narrow and contracted view of the equities of this case to say that the Rubber Companies have no responsibility for these fraudulent statements. Perhaps it may be true that they could not be held liable directly to the injured parties for the resultant damages; but that is not the question. The combination between the parties lacked no essential element of a conspiracy, and the acts and declarations of conspirators, in furtherance of the common design, are the acts of all. What was the common design in this transaction? It was concededly to obtain credit for this company. What was the purpose of these fraudulent statements, and what was their effect? Manifestly to obtain credit for the company. The ordinary methods of business, with which these men were familiar, necessitate the making of financial statements as a means of obtaining credit. The Rubber Companies did not come in contact with persons from whom credit was to be asked, and therefore the very situation relieved them

from the necessity of answering what some of the witnesses called "embarrassing questions." That matter was in the hands of the Fargos as one of the ordinary incidents of the running of the business, and the dummy directors who represented the Rubber Companies *were expressly pledged not to interfere with them in the conduct of the business.* The Rubber Companies, and the agencies which they created and of which they made use, were pledged to advance the common end by the concealment which was intended to deceive. One party to this combination thus aided the accomplishment of its purpose by *suppressio veri*, to which the other added *suggestio falsi.* Each fulfilled the part which was assigned to him, if not by definite arrangement, at least by the natural outcome of the situation which they united in creating.

If moral turpitude is the test, is there so much less of it in suppressing the truth, than in stating a falsehood that a court of conscience will seize upon the difference as a reason for creating degrees of responsibility between wrong-doers?

We contend, then, that as these parties were concededly united in a common plan and actuated by a common intent, the establishment of an intent on the part of the Fargos which was not merely wrongful, but almost criminal, leaves no ground for the contention that their co-conspirators occupied a higher moral plane, or were swayed by more praiseworthy motives. That the acts of one party to the conspiracy within the general lines of its purpose must be treated as the acts of all, *or as showing the intent of all.* And that, even if the Rubber Companies are acquitted of moral turpitude, they cannot, at the

expense of the defrauded parties, be freed from responsibility for the acts of associates with whom they bound themselves in such close alliance.

But if we are to concern ourselves with the view which the Rubber Companies took of this combination, and the appearance which it had to them when they were formulating it, we do not fail to find evidences that they saw it, even if somewhat dimly, in its true light. Mr. Porter made a careful examination of the law with reference to fraudulent preferences by insolvent corporations, and the rights of creditors, who attacked such preferences (*Record, pp.* 446-8). Can we believe, as counsel contend, that there was nothing in the situation which suggested to him the question of fraud and insolvency? He tries to explain this by saying that he feared *subsequent* insolvency. Can we believe that these careful lawyers actually thought that *subsequent* insolvency could in any way impair a security taken in good faith from a solvent debtor? Their acts, too, show that as the result of an examination of the law they actually decided some of these questions contrary to their present contention. It will be remembered that the entire scheme, in all its details, including the judgment notes, and the change in the board of directors was agreed upon, and all the necessary papers, resolutions, etc., prepared before any step was taken. Being one common scheme a court of equity would treat its different steps as parts of the whole and not as disconnected transactions. Yet Mr. Beale and Mr. Porter did not dare to have the resolution authorizing the judgment notes passed by the clerks in their office "*upon the ground that they were substantially preferring the claims of the Rubber Companies*" (*Record, p.* 447). They therefore had that resolution passed by the old board whose

places were to be supplied, as soon as this perfunctory ceremony was performed, by the young men who were already selected for that purpose. The flimsy character of this mere tribute to empty form shows clearly that the transaction was understood to be one whose substance was such that no formality which might give it the appearance of fairness and legality could safely be omitted. And how completely this refutes the contention of counsel (*brief, p. 25*) that "The rule prohibiting directors from preferring themselves when contemplating a cessation of business has no application. The preferences of the Rubber Companies were not to directors. In granting them Fargo & Co. and the Rubber Companies dealt at arm's length."

The view which these men took of the matter, after looking up the law on the question of fraud, is quite clearly shown by Mr. Beale's own statement of the fears which he entertained of the rights which the Metropolitan National Bank might thave to attack the scheme. He says that he discussed with his clients the necessity of not allowing Fargo to borrow any more money from the Bank after the judgment notes were given, because that would put the Bank "in a position *where it could claim to have been deceived.*" In the same connection he says he does not think the position of merchandise creditors entered the mind of Johnson, Sadler or himself. In fact so totally does he say he ignored their position, that he referred only to the Bank in telling Fargo to keep his indebtedness down and refrain from branching out. (*Record, pp. 563-4.*) It is thus admitted that he keenly appreciated that it would be a fraud to *allow* Fargo to obtain credit from one who was ignorant of the facts which he had created. The very question involved in this

ase thrust itself upon him, and was decided adversely to he present contention of the counsel who now represent he clients, who, in 1896, were advised by Mr. Beale that uch a scheme *was a fraud on future creditors.* His houghts, according to his present recollection, were cen- ered on the Bank because it was a definite creditor with whom he was personally acquainted, and of whose posi- ion he was aware; and this may have caused him to for- get or overlook the creditors whose position would be exactly the same, but who were to him an indefinite body of unknown persons. But can this change the real char- acter of the act or of the intent which actuated it? Was it a fraud to borrow from the Bank because Mr. Beale thought of it, but no fraud to buy goods from others, be- cause he did not think of them at all? The proposition is one which is not open to argument. And we answer all the analytical theories of opposing counsel as to in- tent, and "conscious purpose," by the judgment of con- demnation which Mr. Beale and Mr. Porter themselves pronounced. They were simply so blinded by zeal for a client that they did not view the *entire* matter in the true light which all its necessary and logical consequences fur- nished.

In view of all the facts, however, it is clear that the position of subsequent creditors did present itself to Mr. Beale's mind; for how else can we explain the fact that in the written agreement,—which although not signed, he says stated the understanding of the parties—he in- serted a specific provision that judgment should be at once entered against the company if it attempted in any way to create a lien on its assets in favor of existing or *future creditors?* (*Record, p.* 588.)

It is insisted by counsel that the absence of fraud is shown by the fact that the debts of the two Rubber Companies were reduced from January to August to the extent of only about $7,500, and that during the same period the company paid out in the aggregate, a large sum to other creditors. Here again, we submit, counsel confuse the *extent* of a fraud with its existence. The importance of these facts lies not in the amount of the reduction of the Rubber Companies' claims, but in the unwillingness of those companies, *although secured,* to give to the company the same credit which they desired it to obtain from others. If they had voluntarily extended their lines of credit it would have furnished something more nearly approaching evidence of their alleged confidence in its solvency, than is shown by their actual conduct. But that was exactly what they carefully sought to provide against. The money which they advanced would necessarily be largely used in the payment of their own claims, and an actual and absolute increase of their debts was therefore provided against. The money was so used and by far the greater part of the notes of Candee & Co. were taken up as they matured. No goods were sold by either company, but those which were shipped by the United States Rubber Co. were sent on consignment, so that no credit was *given* at all. Stringent measures were provided to keep these goods, even while in the Fargo warehouse, in charge of a custodian for the Rubber Companies; and to keep the proceeds of sales deposited in a special account in bank. The conceded object of all this was to *prevent the possibility* of Fargo & Co. getting from the Rubber Companies the credit which it was to get from others; and so important was this deemed that Mr. Beale thought it wise to remind his clients of the

necessity of "not letting the Fargo indebtedness increase." The indebtedness which arose for consigned goods sold by Fargo & Co. in the interval was not due to any credit *given* the company. On the contrary, Fargo simply failed to deposit *all* of the proceeds of those sales in the special account which the Rubber Companies had compelled him to open. The creation of that debt was an *absolute departure* from the plan as arranged in January and from the intention of the Rubber Companies; and therefore, furnishes evidence against, instead of in support of, their claim of good faith. But even with this increase, the Rubber Companies were better off at the time of the failure than in January, and would have lost less money by a failure then, without their being secured, than they would in January. *This is not true of the complaining creditors.* And this, it seems to us, shows the fallacy of the contention that the fact that the company paid off the debts owing in January has any force against these creditors. It simply paid off a large number of creditors, and then incurred debts with new ones and increased very largely the debts of those from whom it continued to buy. Obviously this increased credit was influenced, if not absolutely secured, by the payment of the previous debts; for clearly no creditor would largely increase his sales to the company, if it allowed prior bills to remain unpaid. Take as a concrete example the case of the Pfister & Vogel Leather Co. In January the company owed it less than $2,000, and in no year had its *total* sales exceeded $10,000, and as the goods were sold on sixty days' time, the balance due at any one time would be very much less than that amount. Between January 6th and June 26th, 1896, Fargo & Co. purchased from it goods to the amount of $20,504.32, more than twice as

much in less than six months, as had ever been previously bought in a year. Payments on these purchases still left a balance of $17,557.90, two and a half times as much as the amount by which the debts of the two Rubber Companies was *reduced*. If the Pfister & Vogel Leather Co. had paid to Fargo, *for the privilege of not giving him further credit*, the $10,000 which, at the time of the failure, he put in his pocket, it would have made money by the transaction.

The debt of Wilder & Co. was increased from $1,275 in January to $4,600 in August; and the debt of the Eagle Tanning Works, to whom a small balance was owing in January, was increased to $2,500, by purchases made after April 1st.

In the face of such examples, and many others which the record discloses, how idle it is to contend that the equities of these defrauded creditors are in any way affected by the fact that others were paid *at their expense*, or by the fact that the small amounts due them in January were paid as a means of getting greater credit. To sustain such a position is to forget the impropriety of "robbing Peter to pay Paul."

THE POSITION OF THE METROPOLITAN NATIONAL BANK IN CONNECTION WITH THE QUESTION OF ACTUAL FRAUD.

The questions relating to the Metropolitan National Bank are dismissed by appellants' counsel with the statement that the Court of Appeals "does not find Bank guilty of actual fraud." Certainly such a form of presenting the case of one who seeks affirmative relief in this court furnishes little ground for discussion, and leaves

what the Court of Appeals says and holds on this question entirely unanswered.

It can hardly be doubted, as a legal proposition, that if the scheme between Fargo & Co. and the Rubber Companies was a fraudulent one, the Bank, by making itself a party to it, and uniting in an endeavor to enforce it against the other creditors, is affected by that fraud. To assist in the accomplishment of a fraudulent scheme originated by another, does not involve a less degree of either moral wrong or civil liability, than to originate the wrongful plan.

The part which the Metropolitan National Bank took in the transaction in August cannot be viewed as the giving by Fargo & Co., or the receiving by the Bank, of an independent security, but must be regarded as a part of the transaction originating in January. All of the witnesses in their testimony speak of it as making the Bank a party with the Rubber Companies in their scheme. So clearly was this seen to be both its purpose and effect, that the consent of the Rubber Companies to this action was solicited by Fargo, before he went to the Bank about the matter. The action of the parties from that time on showed both absolute community of action on their part and a keen appreciation by them of its necessity.

Although it is now pretended that each party believed that the assets of the company were enough to pay, not only their own claims, but those of all other creditors as well, the Bank stipulated that its claim should stand on the same footing as to priority as the Rubber Companies' claims; and the latter—having, upon the theory of innocence in the transaction, no earthly motive for conceding this—agreed to it.

It will be seen that the Bank held a position which made both Fargo and the Rubber Companies anxious to have its interests united with theirs. Fargo desired to get the $10,000 for the personal use of himself and his brothers. The Rubber Companies, as Mr. Beale concedes, had been from the first fearful of the legal right which the Bank might have to attack their preferences, on the ground that it had been deceived. Such deceit, with the knowledge of these parties, had been practiced upon it twice since January, by getting it to grant extensions, which were so plainly obtained by substantial imposition that neither Mr. Beale nor Mr. Fargo was willing to take the chance of obtaining them by a personal interview. Its situation was concededly such that Fargo's own sense of honesty finally revolted at obtaining further extensions from it, even by the tacit misrepresentation involved in merely asking for them. With all these considerations, and the glaring insolvency of the company before them, the parties—to use Mr. Fargo's expression—"opened their arms and took the Bank in."

While some suggestion is made in the brief of opposing counsel to the effect that the Bank did not know of the scheme of preference which the Rubber Companies held, when it took its security, the contrary is not only conceded by all the witnesses on the stand, but is expressly conceded in the answer of the Bank. The answer says that it learned of the existence of an agreement between the Rubber Companies and Fargo, by which the former were in a position to secure preferences over other creditors; that, having learned of this fact, it caused steps to be taken to ascertain the details (*Record*, 113). All that was done in making the Bank a party to the scheme, and

securing its claim, was agreed on in advance and actuated by a common design. It all took place after Fargo had acknowledged his inability to go on in business, and when the only discussion was as to the details of the manner of conducting the failure. This involved the following steps, all of which Fargo says were agreed on before any papers were executed:

1. The advance of $10,000 by the Bank, for the personal use of Fargo and his brothers. This was made to take the form of a loan by the Bank, as a means of disguising it from mere embezzlement; but that all parties knew the money was going to stay in the hands of the Fargos, to whom it was paid, is conceded.

2. The conveyance to the Bank of the Dixon property, in payment of $25,000 of its debt.

3. The consolidation of the claims of the Bank and the Rubber Companies and of all securities which each received, and an agreement to divide *pro rata* all moneys which either collected. This agreement was not limited merely to an agreement for division, but in express terms provided "that the parties had determined to unite their efforts to collect their respective claims against said company, and share *pro rata* in the results thereof." It also provided that all of the property of the company, including the real estate conveyed to the Bank, should be subject to the "control, management and manipulation of the firm of Isham, Lincoln & Beale, who should act as trustees for all parties, and whose actions and judgment should be conclusive." (*Record*, 385-6.)

It is difficult to believe that the Rubber Companies, in making an agreement of this kind, were not actuated by a lively sense of the danger which they had to fear from

an attack by the Bank, and the desire to actually bind it to sustaining their preferences. And from first to last the conduct of all these preferred creditors has been consistent with the terms of this agreement. The same counsel represents them in this court, and the only theory upon which he presents their case is, not that the Bank stands in any better position than the Rubber Companies, but on behalf of the Bank he champions the cause of the Rubber Companies and denies that they were guilty of any fraud.

That the true relations between the Rubber Companies and Fargo were plain to Mr. Keith's keen business intelligence the moment the matter was broached to him, is shown by his own words, in which he says that he saw that the directors of Fargo & Co. were acting under the control of the Rubber Companies, and that Fargo was a tool in their hands.

The $10,000 which the Bank advanced to the Fargos was concededly paid as a part of the scheme of preference, and with knowledge by Mr. Keith that it was to be used for the personal benefit of the Fargos. An attempt is made to cloak this fact by the assertion that the Fargos had some sort of a claim on the company, warranting them in taking this money. It is perfectly obvious that, as officers of the company, they could not secure a preference over other creditors at the time of its failure. And by the law of Illinois, an attempt to do so is fraudulent; and an attempt to collect the claim of an independent creditor by consolidating it with such a preference affects even the good claim with the fraud and avoids a preference which covers both. This is decided in the case of *Atwater* v. *American Exchange Nat'l Bank*, 152 Ill., 605.

But there is no evidence in this record from which it can be satisfactorily concluded that in fact the Fargos had any such claim against the company. Certainly the burden was not upon the complainants to make any showing of the non-existence of such a claim, after Mr. Fargo had specifically testified that he obtained this money for himself and his brothers to live on, and told Mr. Keith that that was his purpose. This testimony shifted the burden of proof to the defendants to show justification for the payment of the money. Their testimony on the subject was limited to showing that Mr. Fargo told Mr. Keith that he and his brothers had pledged their bank stock as security for their individual notes, but had used the money in the company's business. No attempt was made to prove, by either Fargo or his brothers, that in fact any such transaction as this had taken place. In saying this we do not overlook the fact that, in response to a very general and leading question put by Mr. Beale, Fargo said that he and his brother had advanced more than $10,000 to the company (*Record*, 265). No statement was made as to when the money was advanced, by which one of the brothers, whether it was the money obtained on the notes secured by the pledge of the bank stock, or any other detail of the transaction given—or even a statement that the money remained unpaid. On the contrary, a very different coloring is given to it, when it is remembered that this answer was given as an explanation of the witness' statement immediately preceding, that the money was divided between him and his brothers, "because we had to have some money to live on, and the corporation owed it to us." The absence of any evidence actually showing the existence of a debt which could justify the payment of this money is strikingly significant.

The intent with which parties enter into a transaction is often evidenced by an attempt on their part afterwards to cover up its real nature. An excellent example of this is furnished by the sharp contrast between the testimony of Mr. Fargo and that of Mr. Keith as to the actual transactions which occurred at the time of the failure and the description of those transactions in the answer of the Bank and in the affidavit of Mr. Keith filed in the case. In that answer and affidavit the transactions involving the Bank's security, the advance of the $10,000 and the determination of the Bank to buy the land, are stated as separate, successive and independent transactions, and an evident attempt made to state them as not being brought about by the corporation's insolvency. (*See answer, Record,* 112-13; *Affidavit,* 659-661.)

Both the Rubber Companies and the Bank are now, in addition to this, jointly contending that the Bank should not only have its claim recognized and paid, but paid to the full extent of $50,000, notwithstanding half that amount was satisfied by the transfer of the land. For some reason, which we cannot understand, and which may have been the result of pure oversight, the Circuit Court adopted that view, and directed the payment of the Bank's claim *pro rata* with other creditors at its original amount. This is obviously in the teeth of the conceded facts. It is testified to by all the parties that the Bank received the land in payment of one-half of its debt, and actually canceled and surrendered the $25,000 note. So that it has, even against Fargo & Co., no claim exceeding the amount of the remaining note.

So far from ever repudiating or seeking to set aside the cancellation of the debt, it set the fact up in its an-

swer, asserting its ownership of the land and the discharge of the debt. There is no pretense that any misrepresentation was made in inducing it to accept the land at this valuation, or that it did not know all of the facts. If there were a cross-bill or other proceeding for the purpose of relieving the Bank from the effect of this cancellation of the debt, the evidence which this record furnishes would inevitably defeat the attempt. The transaction is binding as between Fargo & Co. and the Bank. The Bank still has the deed which it accepted, and Fargo still has the canceled note which the Bank delivered to him.

The $10,000 which the Fargos obtained from the Bank can be included in the latter's claim only at the expense of the violation of the equities of the defrauded creditors. To add to this the injury of paying the claim on the basis of its original amount, would simply put a premium upon fraud. This is not a matter which concerns the Bank alone, but the Rubber Companies, who share in whatever it collects, are also interested in enforcing this grotesquely unjust view of its rights. They are seeking thus to escape—and at the expense of an added fraud on the creditors—the result of the taking of the land, which they now wish to exchange for cash at par.

The authorities upon the subject of fraud and fraudulent intent are collated in the brief of our associates; and they answer fully the legal propositions put forward by petitioners' counsel. Indeed, it seems to us that the legal question must be decided by reference to fundamental principles about which there can be no dispute. It is true that, in speaking of fraud in fact, courts sometimes say that it is fraud which involves "intentional wrong." But

this does not at all involve the idea that the guilty party must intend to do evil *as such*. The law does not concern itself with the inquiry whether he actually perceived the real quality of his act. It does not make him the judge of the rights of the person affected by his acts, nor limit those rights by either his view of them or his disregard of them. It places all men upon a mental and moral equality, and holds them responsible for the natural consequences, whether actually foreseen or not, of their deliberate acts.

In the case at bar the Rubber Companies concededly intended that third persons should be induced to sell the goods upon a false basis, and that they should not get pay for those goods until their own claims were satisfied. This was the end for which all the elaborate machinery was prepared. To call it anything less than a fraud is to deny the evidence of our own senses. To say that it is not an actual fraud is to blind ourselves to the effect which its accomplishment produced upon those at whom it was directed.

II.

THE PREFERENCES WERE CONSTRUCTIVELY FRAUDULENT AS TO THE RESPONDENTS.

If the facts and circumstances shown by the record establish actual fraud, then upon the principle that the greater includes the less, the preferences were constructively fraudulent as to the respondents; and any consideration of the question of fraud in law, as distinguished from fraud in fact, is unnecessary. However, counsel for petitioners urge upon the court the proposition that the Jaunary arrangement, upon the facts disclosed by the

record, was not even fraudulent *per se*. In other words, the court is asked by counsel to say that the January agreement and the preference thereby secured should be regarded with favor by a court of equity, and upheld as a judicially sanctioned scheme and possibility in business. If the law approves of the transactions in question, and a court of conscience shall say that there is nothing in the conduct of petitioners which should be condemned, then a method has been discovered, or for the first time has been brought into effective operation, whereby, through the form of a corporation and corporate action, results may be contemplated and accomplished which heretofore have been uniformly condemned. To reconcile such a decision on principle with well-established and approved precedents, it would be necessary to resort to no little discriminating casuistry.

In this case there is very great difficulty in discussing the question of fraud in law, as distinguished from the actual fraud disclosed by the evidence, for the reason that the facts bearing upon both questions are concurrent and so intimately commingled and related that they are inseparable. The intent and object is also expressed or confessed, therefore any discussion of either question by taking up one particular fact or transaction after another and considering it by itself, and unrelated to the other facts and transactions involved in the scheme, and the intent and object thereof, as counsel for petitioners have done, must be illogical, faulty and without value to the court, which is called upon to pass judgment upon the legality of the scheme as a whole. For the same reason, any discussion of the preferences apart from the expressed motives and intentions is impossible.

This arrangement between the Rubber Companies and the Fargo company clearly contains the following elements:

First: The Rubber Companies obtained the power to quickly sieze and convert, at their pleasure, or, in case of disaster, all existing and all after-acquired property of the Fargo company, whether tangible or intangible.

Second: The transfer of the corporate power of the Fargo Company to the Rubber Companies, or their agents who were to act in their interest, whereby they could prevent the Fargo Company from preferring any other creditors.

Third: The Rubber Companies were given possession of the corporate powers of the Fargo Company while the Fargos were held out to the world as being in control of the company and its assets.

Fourth: It contemplated that the Fargos were to carry on the usual business of the company, buy goods on credit and sell and appropriate the proceeds as they saw fit until the Rubber Companies elected to appropriate the assets of the Fargo Company to their own demands.

Fifth: The confessed purpose was, not so much to secure a payment of the indebtedness of the Rubber Companies at a definite time, as to erect a barrier generally against all other creditors during the indefinite period allowed to the Fargos to ostensibly manage the business and prevent creditors from obtaining any lien or security at all after the Rubber Companies had appropriated the assets to their own demands.

Sixth: Another essential element, and the confessed purpose, was to keep the whole arrangement and situation

secret in order that the company might obtain goods on credit from third parties who were ignorant of the situation.

The master finds (*Record*, 162) that the various steps taken "were all for the purpose of giving preferential security to the Rubber Companies, and the matter was kept secret in order to allow the Fargo Company an opportunity of getting through embarrassments apparently temporary, but not with a fraudulent intent as to the other creditors of the company. The only purpose and object of changing the board of directors, as aforesaid, and of amending the by-laws was to protect the Rubber Companies against the giving by the Fargo Company of preferential security or judgment notes to other of its creditors which should be superior to the security of the Rubber Companies."

Without stopping here to refer specifically to other facts shown by the record bearing upon the question, for it would involve a repetition of what appears in the brief of our associates for respondents, we maintain that the natural and logical effect of the January arrangement and the conduct of the parties thereunder and in execution thereof, to use the language of the court in *Hilliard* v. *Cagle*, 46 Miss., 309, quoted and approved by this court in *Blennerhasset* v. *Sherman*, was

> "To mislead and deceive the public and induce credit to be given to the mortgagor which he could not have obtained if the truth had been known, and therefore the whole scheme was fraudulent as to subsequent creditors, as much so as if it had been contrived from that motive and for that object."

The authorities cited in the brief of our associates upon this question we do not here repeat, but respectfully refer the court to them in support of our position.

Counsel say: "The contract being legal, it was not only right, but the duty of the Fargo Company to carry it out."

We deny the assumption that the contract was legal. We contend that it was not only not the duty of the Fargo Company to carry out the scheme, but it was its duty, and the duty of its officers and directors, to refrain from its execution, because it was fraudulent. One of the vices of the arrangement was that it was to be kept secret, and was kept secret for the purpose of allowing the Fargo Company an opportunity of getting through its embarrassment by continuing in business in the ordinary way, and obtaining goods on credit and borrowing money from those who were ignorant of the truth. Secrecy, for this purpose, makes the arrangement fraudulent in Illinois, for this is "a fraudulent intent as to other creditors." The elements of secrecy and a dishonest motive are both present in the January arrangement. The contract was illegal and it was not the duty of the Fargo Company to carry out a fraudulent contract.

THE CHANGE OF DIRECTORS AND AMENDMENTS OF THE BY-LAWS.

The master found that the "only purpose and object of changing the board of directors, as aforesaid, and of amending the by-laws was to protect the Rubber Companies against the giving by the Fargo Company a preferential security or judgment notes to other of its creditors which should be superior to the security of the rubber companies."

The draft of agreement (*Record*, 588, 589) between the Rubber Companies and the Fargo Company, which

Mr. Beale (*Record,* 555) testifies expressed precisely his understanding of the agreement at the time, provided as follows:

"The directors and officers elected at the instance of the said Beale shall aid and not interfere with or hamper the proper carrying on of the ordinary and usual business of the Fargo Company, substantially as heretofore carried on, *but they are expected to act as may be necessary to guard and protect the interests of said Johnson and of said two creditor corporations under this agreement.*"

Upon this point Mr. Beale (*Record,* 567) testified as follows: "Q. Then the conversation centered upon the giving of judgment notes, and that did not appear to be to you entirely satisfactory, for the reason that the Fargos might give security to other people which might interfere with your security under the judgment notes. That is true, I suppose? Ans. (Mr. Beale) That is correct also. Q. And, to meet that objection, Mr. Fargo suggested that a board of directors pledged to the Rubber Companies might be put in and thus any action of that kind might be prevented? A. (Mr. Beale) That is correct."

Mr. Beale further testifies (Record, 569): "I assumed that the young men who are in my office had sufficient confidence in me so that, if I had asked them to take any action, so it did not at once offend their moral sensibilities and seem to them to be wrong, they would have done it, relying upon me. I do not question that for a moment."

The facts and circumstances surrounding the appointment of these gentlemen as directors of the Fargo Company and the confessed object and purpose for which they were placed in the directory of the company is so plainly inconsistent with an honest purpose that the law will con-

clusively presume a fraudulent intent. It constitutes almost conclusive evidence of fraud and bad faith. Having for its object and purpose deceit upon subsequently drawn in creditors and the warding off, hindering and delaying of creditors, it cannot be said to have been made in good faith and without fraud. The placing of men in the directory representing interests hostile to the company is illegal, for the reason that they cannot serve both interests, the interests of the company and the interests of their clients, the Rubber Companies. We have no doubt that such a change of directors as this case presents is in itself fraudulent and is in itself an evidence of fraud of the highest character. The directors nominated by counsel for the Rubber Companies had no interest in the company, had no interest in its business, had no knowledge or experience necessary to make them fit persons for directors. They were not put there for any legitimate or legal purpose. They were put there with the express understanding and instruction that they were to act in the interests of the Rubber Companies and would devote no time and attention to the interests of the Fargo Company. The by-laws were amended so as to make their power over the company more complete, and the power of the general officers of the company was limited to the merest details of running the business in the ordinary course of trade. This change of directors was a means to a fraudulent end.

It does not relieve the situation or change in any manner the legal effect of the change of directors and the amendment of the by-laws to say that it was done "solely for the purpose of assuring the performance of this agreement," when the agreement expressed an illegal purpose

on its face. Wholly apart from such expressed and confessed purpose, the change of directors and by-laws was fraudulent in law, because it carries with it the implied and irresistible inference that it was for the purpose of having a board of directors pledged to the interests of the Rubber Companies and that the change of by-laws, in connection with all the other facts, would have no other purpose nor effect than to hinder and delay creditors existing or subsequently drawn in.

Counsel for petitioners ask (*Brief*, p. 40) what right of creditors is here infringed? We answer: the right that their debtor shall at all times be free to treat them justly and to do everything in his power to pay or secure their debts; that he shall not be bound hand and foot by any other creditor or creditors who hold secret liens or the secret machinery for acquiring liens upon the goods and property sold by them to the debtor on credit in ignorance of his position and condition. As "the right to prefer is based upon *jus disponendi*, which the owner of property retains so long as his ownership continues," to use the language of respondent's counsel, every creditor has the corresponding right to extend credit, based upon the assumption that the debtor still retains his *jus disponendi* until it has been exercised in some way known to the law and evidenced by public record or a change of possession. The change of directors and of by-laws in fact and by design deprived the Fargo Company of this right, and necessarily and expressly contemplated that, after it was so deprived of this right, secretly and by no recognized form of legal security, it should continue its business in the usual way by purchasing goods on credit and borrowing money. Thus the rights of such of the cred-

itors who were kept in ignorance of the change of directors and of the by-laws were infringed, and therefore the law condemns the scheme. True, the debtor may always exercise his discretion as to this power to prefer, but he cannot secretly submit to a restriction upon it or a total surrender of it in the manner and for the purpose here contemplated.

Experience has demonstrated that human nature, whether in its corporate capacity or its natural state, cannot be relied upon to do justice under all circumstances; hence the appeal of counsel to human nature as a basis or guide or safeguard to just corporate action is, to say the least, unsatisfactory and doubtful. And this case furnishes an example of what human nature can be expected to do under stress of circumstances.

THE PREFERENCE OF THE METROPOLITAN BANK WAS FRAUDULENT IN LAW.

The manner in which the bank became a party to the January preference is shown by the testimony of Mr. Charles E. Fargo and Mr. Keith (Record, 190, 192, 385, 389) and by the action of the directors and stockholders of the Fargo Company (Record, 67, 69) and the written agreement between the Rubber Companies and the Bank (Record, 385).

From this it appears without question or controversy that (1) the loan of the $10,000 for the private use of the Fargos by the Bank, (2) the giving to the Bank of the two judgment notes of $25,000 each, (3) the agreement between the Bank and the Rubber Companies and the Fargo Company, and (4) the acceptance by the Bank of the Fargo Company's

factory property at Dixon, Illinois, in payment of one of the notes, were all parts of the transaction, which professedly involved (5) the failure and wrecking of the Fargo Company, and (6) the seizure of all its assets, including the property secured and acquired by the Fargo Company while operating under the January agreement, and (7) the appropriation of everything to the demands of the Rubber Companies and the Bank, *pro rata*, under the machinery provided by that scheme.

The purpose for which the Bank loaned the $10,000, and the use to be made of it by the Fargo Company, or the Fargo brothers, is shown by the testimony above referred to. The money was not to be, and was not, as a matter of fact, used for any legal corporate purpose in carrying on the business of the company, for that business was to be suspended at once. It was to be used by three stockholders, two of whom were directors of this insolvent company then in the final act of failure, for their own private use and benefit. In other words, the Fargos used their power as officers of the company to convert its assets to their own benefit when they were trustees for the creditors, and the Rubber Companies, and the Bank actively assisted them in so doing, with full knowledge of all the facts and the illegal purpose.

That this was an unlawful preference admits of no argument beyond a statement of the facts. That it vitiates and makes illegal the preference to the Bank which was created wholly or in part in consideration thereof does not seem to admit of argument before this court at this period in the history of corporate jurisprudence. Many questions have been settled, and this one among others.

As to the effect upon the preferences to the Bank pro-

duced by its becoming a party to the original January scheme, which was thereby made an essential part of the preference, we need only to say that, if the original scheme was fraudulent, the preference to the bank which became a part of it was necessarily fraudulent. For courts will not make new contracts for parties by striking out the illegal parts of contracts and giving effect to the other portions. If fraudulent in part, the contract as a whole is saturated with the fraud and, consequently, is illegal.

This leads us again to the question as to whether the original January scheme was fraudulent. Upon that question we respectfully refer the court to what we have already said in discussing it and to the brief of our associates upon the same point.

III.

SHALL THE PETITIONERS BE ALLOWED TO PRO-RATE WITH RESPONDENTS IN THE $104,000 NOW IN THE HANDS OF THE RECEIVER, REALIZED FROM THE SALE OF RESPONDENTS' GOODS?

Every case must be decided upon the facts shown in that particular case, and we respectfully submit that under the peculiar facts shown in this case, the claims of the petitioners should be postponed to the claims of respondents. An entirely new scheme has been devised by the counsel for petitioners to confiscate all the assets of an insolvent corporation and still permit it to continue in business and defraud its creditors. The decision of this court on the questions involved is of vital importance to the commercial world.

The peculiar facts regarding the scheme of the petitioners is as follows:

During five or six days in January, 1896, Johnson and Sadler, as representatives of the U. S. Rubber Co., and L. Candee & Co., with full knowledge of the insolvency of C. H. Fargo Co., endeavored to get a preference for these Rubber Companies over other creditors of the Fargo Company, but were at first unable to do so.

The U. S. Rubber Company then held $140,000 overdue indebtedness (Rec., 289) against the Fargo Company, and L. Candee & Co. held its notes for $44,900, then about to mature, given for an indebtedness which matured on May 1, 1895 (Rec., 514), and there was then a contest between the Rubber Companies and Fargo Co. as to whether or not about $100,000 worth of rubber goods then on hand were consigned or sold to Fargo & Co. At first these representatives tried to get a chattel mortgage which the Fargo Co. refused to give, because placing it on record would ruin their credit, it being then their desire to continue the business long enough to get some money for themselves, and to have the company take up some of its notes then outstanding on which they were individually liable as indorsers. Next Johnson asked for demand judgment notes and these the Fargos refused to give, unless Johnson would advance sufficient money to carry the Fargo Company along a few months longer. Johnson (Rec., 511) says that it was not until after Fargo told him in effect that unless he advanced additional money they would make an assignment and treat all of their creditors alike, that he decided to make the advance.

Being thwarted in the scheme to get a preference on their claims, then amounting to $184,900, and there being

a contest over $100,000 worth of goods claimed by Johnson to have been consigned and not sold to the Fargo Co., Johnson deemed it best to advance $50,000 and increase the debt to $234,900, *provided* this larger sum could be *absolutely secured beyond all question.* In doing this, if the scheme then under consideration succeeded, he would accomplish what he came to Chicago for, namely, to get security for the debt of $184,900—$140,000 to U. S. Rubber Company and $44,900 to Candee & Co.—Johnson then knew that if an assignment was made, as threatened by Fargo, that the Fargo Co. assets would not pay over twenty-five cents on the dollar to its creditors, and that on the claim of $184,900, which he represented, the Rubber Company would get only about $37,000, and with such a result staring him in the face, the fraudulent scheme, of which we complain, was concocted and carried through between Fargo, Johnson, Sadler and Beale—Fargo was agreeable to any plan which would result in carrying the business along until the $15,000 of notes endorsed by him and his brothers could be paid off. Johnson was willing to do anything that Beale said would be absolutely safe, and thereupon Beale prepared an agreement in writing to be signed by the Fargo Co. providing as follows (words in brackets are ours):

"*First.* Said Johnson will advance, *or cause to be advanced,* to the Fargo Co. the sum of $50,000, of which sum there shall be furnished $10,000 on the date hereof; $10,000 on or before January 10, 1896; $10,000 on or before January 16, 1896, and the remaining $10,000 on or before January 20, 1896; which said advance of $50,000 *shall be used by the Fargo Co. to reduce the amount of its indebtedness as it matures* (meaning the L. Candee & Co. notes then maturing). For the re-payment of said

$50,000 to be advanced in installments as aforesaid, the Fargo Co. *shall this day*, Jan. 6, 1896, give its several promissory notes to L. Candee & Co., aggregating that amount, *which said notes the said Candee & Co. intends to indorse and discount for the purpose of obtaining said sum so to be advanced.*

"*Second.* The Fargo Co. *shall on this date* also execute and deliver its three judgment notes as follows: One note for $140,000, payable to the United States Rubber Co. to secure the said indebtedness to that company—one note for $45,000, payable to L. Candee & Co. to protect and secure that company against its liability upon the discounted notes of the Fargo Co. heretofore given in the sum of $44,900, and one note for $51,500, payable to L. Candee & Co. as further security to that company for $50,000, herein agreed to be advanced to the Fargo Co. as aforesaid, and interest thereon, and to protect and secure said L. Candee & Co. against its liability upon the plain promissory notes evidencing such advance, *which it is the purpose of said L. Candee & Co. to endorse and discount—each of said judgment notes to be payable on demand* and to bear interest at six per cent. per annum.

"*Third. The Fargo Company*, to further secure said *indebtedness hereby assigns and transfers to said Johnson all such book accounts, credits*, bills receivable and choses in action as shall be owned by, or due to it whenever judgment shall be entered on said judgment notes or either of them. * * *

"*Fourth.* The board of directors of the Fargo Co. shall be at once reorganized so that of seven directors there shall be five new ones nominated by or acceptable to Wm. G. Beale, of counsel for said Johnson. Chas. E.

Fargo, one of the present directors, shall remain president of the Fargo Co. as heretofore, and the offices of secretary and treasurer shall be filled by a director or by directors so to be placed in the board at the instance of said Beale. Such directors or their successors elected likewise at the instance of said Beale shall retain their places in said board as long as desired by said Beale, or until they shall resign under the provisions of this agreement.

"*Fifth.* * * * Any one of the following specified contingencies shall at the election of said Johnson justify the confession of judgment upon said notes prior to July 1, 1896, that is to say:

a. The execution, except as herein provided, in the name of the Fargo Company, by any of its officers or directors, not elected at the instance of said Beale, *of any judgment note, or of any warrant of attorney for the confession of a judgment upon a note or account or other liability.*

b. The execution in the name of the Fargo Co. by any of its directors or officers not elected at the instance of said Beale, of any mortgage or assignment or other instrument designed and adapted to create any lien or security upon any property or assets of the Fargo Co. in favor of any existing OR FUTURE CREDITOR OF THE FARGO CO.

c. The institution or progress of any suit or legal proceeding against the Fargo Company, so as to render probable or imminent the issuance of an execution against the Fargo Company, or the establishment of an attachment or other lien upon its property or assets beyond the seeming ability of the Fargo Company to promptly pay the amount of such execution or lien.

"*Sixth.* * * * *The directors and officers elected at*

the instance of the said Beale shall aid and not interfere with or hamper the proper carrying on of the ordinary and usual business of the Fargo Company substantially as heretofore carried on, but they are expected to act as may be necessary to guard and protect the interests of said Johnson and of said two creditor corporations under this agreement.

"*Eighth. The Fargo Company shall at once open and shall hereafter keep separate sets of books* to show fully the business done by it under its consignment contract with the United States Rubber Company, in order to keep, as required by said contracts, the accounts of said consignment business and money of said Rubber Company *at all times separate and distinct*, so far as possible, from the accounts and moneys of the Fargo Company. * * *"

Regarding this agreement Mr. Beale testified as follows (Rec., 555):

"Although not signed, that written draft of agreement represented what was agreed to, and what was sought to be done between the companies in the January arrangement." On January 7, 1896, when Beale showed Fargo a telegram from Johnson reading as follows:

"I think position should be made absolute soon as possible, by completing agreement as arranged, and organization of board of directors to prevent giving other judgment notes—this before we make further money advance—failure to thus protect us, should result in executions by us. Use at your discretion all judgment notes in your possession in order to put our claim beyond peradventure."

Fargo at once saw that Johnson had out-generaled him

by getting possession of Fargo & Company's judgment notes payable on demand, and immediately agreed with Beale that he would waive the conditions, under which judgments might be entered on said notes before then exacted by him, and leave the matter entirely in the discretion of the Rubber Companies (p., 438), and Johnson, as to when judgments should be entered on the notes.

The next step in the scheme, was to have the directors and stockholders of the Fargo Company convene and pass a resolution, "that *whenever it shall be found necessary for this company to suspend business,* it will then assign and transfer to said Johnson for said Rubber Company (U. S. Rubber Company and L. Candee & Co.), all such book accounts, credits, bills receivable and choses in action as shall be then owned by or due to this company."

Then Beale required the Fargo Company to execute and deliver to him its five plain notes for $10,000 each, and one judgment note for $51,500 payable on demand as consideration for the $50,000 which Johnson proposed to advance. Also another judgment note for $45,000 payable on demand, to secure L. Candee & Co. as guarantors on the $44,900 of notes previously given, which Johnson claimed had been discounted at eastern banks, and also another judgment note for $140,000 payable on demand to the U. S. Rubber Company for its claim making, in all plain and judgment notes of the Fargo Company in the possession of Beale as follows:

To L. Candee & Co. (Plain notes)	$ 44,900
To L. Candee & Co. (Plain notes)	50,000
To L. Candee & Co. (Judgment notes)	45,000
To L. Candee & Co. (Judgment notes)	51,500
To U. S. Rubber Co. (Judgment notes)	140,000
Making a total of	$331,400

Thus for debts owing L. Candee & Co. and U. S. Rubber Company, amounting to $234,900, including the promised advance, Fargo & Company gave notes to the amount of $331,400, and of this sum $236,500 *was in judgment notes,* payable on demand. On January 8, 1896, Beale required a meeting of the stockholders of the Fargo Company to be held, when he further insisted that Gilbert E. Porter, George C. Madison, Tiffany Blake, Buell McKeever and Frederick B. Fuller, clerks in his office, should be elected directors of Fargo & Company. On January 9, 1896, this new board of directors of the Fargo Company elected Charles E. Fargo, president, Frank M. Fargo, vice-president and Buell McKeever, its secretary and treasurer, and then on motion of Mr. Porter in compliance with the prearranged plan, the by-laws were amended so as to withdraw from the officers the power of giving any judgment note, chattel mortgage or lien of any kind, except on special authority from the board.

THE TWO RUBBER COMPANIES IN COMPLETE CONTROL OF C. H. FARGO & COMPANY, ON AND AFTER JANUARY 9, 1896.

The two Rubber Companies being on and after January 9, 1896, in absolute control of the Fargo Company, the next and most important step to be taken by the new combination, was that the Fargo Company should go on with its business and buy goods and materials on credit, out of which, in the interest of the Rubber Companies to raise money sufficient to pay the Candee & Co. and United States Rubber Company's notes as they matured, and in the interest of the three Fargos, to pay off the Fargo Company's notes on which they were individually

liable as guarantors, and to be able to keep all creditors from whom they were to buy goods in ignorance of the trap which had been laid for them.

Between January 9, and August 6, 1896, C. H. Fargo & Company, while under the control of the United States Rubber Company, purchased goods and borrowed money on credit from 167 different creditors, who have proved their claims in this case (Rec., 137 to 141), amounting to $180,038.63.

SCHEME TO DECEIVE CREDITORS BY USING OLD LETTERHEADS OF C. H. FARGO & COMPANY.

Although on January 9, 1896, Buell McKeever, by Beale's direction, had been elected secretary and treasurer of the Fargo Company, it was decided, in furtherance of the secret scheme which had been arranged, to use in the conduct of their business and in ordering goods the old letterheads of C. H. Fargo & Company, on which it was printed as follows:

"Chas. E. Fargo, Prest.
Factory, Dixon, Ill.

Frank M. Fargo,
V. P. & Treas.

Edward A. Fargo,
Secretary.

C. H. FARGO & CO.,

MANUFACTURERS OF BOOTS AND SHOES,
196-198-200 MARKET STREET, CHICAGO."

And it is admitted in the record that no other or different letterheads were used by the Fargo Company in carrying on its business after January 9, 1896, and it is shown by the record that the respondents received hun-

dreds of orders for goods from the Fargo Company written on these letterheads.

Thus equipped, the Fargo Company secretly run by the representatives of the Rubber Companies, went to the Dixon Banks to borrow money, and in the markets east, west and everywhere to buy large quantities of merchandise, leather and findings, on credit with which to run their store in Chicago and their factory at Dixon. Not a dollar in money was provided in the January scheme with which to buy these items, without which, the factory could not run or the stock of goods in Chicago be replenished. Judge Grosscup said in his first opinion:

> "The arrangement under consideration is, in its practical aspects, an effectual, secret lien upon a stock of goods in trade under circumstances that justify the trading world into giving security to which the trader is not entitled. There is no name in the vocabulary of the law, so far as I know, exactly fitting it. It is an arrangement possible only to a corporation. An individual trader cannot so divide himself that one personally conducts the business and receives the proceeds, and another holds exclusively the reins of power. An individual can, by no arrangement except a lawfully executed mortgage, debar himself from doing as he pleased with that which is his own and acting as he pleases toward those to whom he is under obligations. With an individual, in contemplation of law, the right-hand always knoweth what the left-hand is doing. But here is presented a case where the actual personality of the trader is one intellect or set of intellects, and the power-holding personality another. The Fargos conduct the business, receive the proceeds, and appear to the world as the dominating will of the concern. The young men in the office of the favored creditors' counsel, held all the powers of action. The Fargos were the corporation of C. H. Fargo & Company, as the world knew and dealt

with it, but were as helpless as their neighbor across the street, as the law technically knew and dealt with it. The device under consideration, so cleverly dealt with the corporation, that while the personality of the Fargos stood out as the controlling power and would, in fact, have obtained the benefits of success, an invisible barrier in control of the favored creditors made them impregnable, not only to attack, but helpless against appeal to their sense of justice by other creditors. The device accomplished for the Fargos and the favored creditors, all that a secret chattel mortgage with possession and power of sale remaining in the mortgagor, could have accomplished, and must, therefore, be treated, in equity upon all considerations of justice and reason, as such a mortgage would be treated."

Judge Woods, in his opinion (Rec., 725), says:

"The scheme adopted, which, if upheld, though not constituting a recognized form of lien, would be a better security than a chattel mortgage, was accepted not only because it made secrecy possible, but because it made exposure impossible, if those employed to execute it kept faith; and that every one of them understood, or was made to understand, that once the scheme was on foot his chief responsibility would be to maintain a discreet silence, the proof is clear, and there has been no attempt or apparent disposition to deny. * * *

"Whatever may be thought of the legislative policy which permits the execution and long holding of unrecorded judgment notes, the decisions cited afford no precedent, direct or inferential, in justification of the scheme in question, the like of which, we believe, if ever conceived, never before was brought into effective operation. As a judically sanctioned or commercially accepted possibility in business, it is unbelievable. It could be attempted only by a corporate debtor, and its approval by the courts would afford a new and fruitful motive for the creation of corporations by the many who would

be quick to avail themselves of so promising a method of pursuing hazardous enterprises at the risk of others."

Mr. Beale evidently did not have any great amount of confidence in his new preferential method, for he says Rec., 564), that he advised Charles Fargo not to increase the Fargo & Company's indebtedness at the Metropolitan Bank after the January arrangement, and that it would not be safe to put the Metropolitan Bank in a position where it could claim to have been deceived. He must have been willing to take chances of deceiving respondents and other merchandise creditors, for he had them in mind when he drew the agreement in January. In that agreement, it was expressly provided, that if any director or officer of the Fargo Company executed, "any instrument designed and adapted to create any lien or security upon any property or assets of the Fargo Company in favor of any existing *or future creditors* of the Fargo Company," judgments by confession might, at the election of Johnson, be entered on the judgment notes taken by the Rubber Companies.

Inasmuch as no more shoes could be manufactured at the Dixon factory without purchases of leather and findings being made by Fargo & Co., it is hardly to be believed that the way and manner in which this stock was to be obtained was not thought of; but, on the contrary, the mind is forced to believe that this phase of the situation was discussed, and it is fair to presume that the largely increased purchases made by the Fargo Co. from American Oak Leather Company, Pfister & Vogel Leather Company, Eagle Tanning Works, Wilder & Co. and others were made in pursuance of a plan which was devised and discussed during the January negotiations.

Judges Woods and Jenkins in their opinion in the Court of Appeals say: "The inventors of the scheme were bound to apprehend its probable consequences."

Petitioners' counsel now pretend that the $50,000 was advanced by Johnson to put the Fargo Co. upon its feet again and that this assistance was rendered to tide them over a temporary embarrassment. This theory, we insist, is an afterthought, for it is conclusively shown that this $50,000 was advanced in amounts and on about the days when the $44,900 notes due L. Candee & Co. matured and the money advanced could be used for no other purpose than paying the notes as they matured. Did this advance put the company on its feet again when Johnson, for the U. S. Rubber Company, demanded and took its demand judgment note for $140,000? What firm or corporation could be said to be in a safe financial condition with an outstanding demand judgment note for $140,000? Had Johnson, in fact, been desirous of putting the company in a condition to continue its business, he would have granted it an extension on its plain notes without interest for the $44,900, owing Candee & Co. and also for the $140,000 owing U. S. Rubber Co., and a further line of credit for such goods as were needed to replenish the stock and allowed it to advise other creditors of such action. Will any sane man believe for a moment that at the conclusion of this fraudulent January scheme, when Fargo & Co. was bound hand and foot by the Rubber Companies, with a gag in the mouth of every one connected with the establishment; with $236,500 of its demand judgment notes outstanding and in the hands of Beale; with five of its seven directors ready at the bidding of Beale to assign and transfer to the Rubber Companies all of its outstanding accounts and assets of every

name and nature, that its embarrassment was only temporary? Is it not the more probable that the Rubber Companies, feeling themselves to be secure in any event, let the Fargos proceed about as they saw fit and pay off the company's notes on which the brothers were individually liable, and is it not true that such notes were paid before April 1, 1896? What becomes of the petitioners' claim that they regarded the embarrassment of the Fargo Co. as only temporary, when we read from Mr. Beale's letter of May 5, 1896, to U. S. Rubber Co.: "There is only one thing about which I wish to caution you in this connection, and that is, *not to let the Fargo indebtedness increase*, because any such increase would not be protected by the judgment notes."

At the time Mr. Beale wrote this letter Fargo & Co. was increasing its indebtedness, three, four and fivefold to American Oak Leather Company, Pfister & Vogel Leather Company, Eagle Tanning Works, Wilder & Co., and others.

Is it not a significant fact that during June and July, 1896, while Charles Fargo was asking extensions from the Pfister & Vogel Leather Company, and the American Oak Leather Company, and was falsely stating to Mr. Vogel that Fargo & Co. had no outstanding judgment notes and that no creditor had any preferences, Fargo & Co. paid to the U. S. Rubber Company three payments of $5,000 each? (Rec., 596.)

If there was no collusion between Charles Fargo and Mr. Beale, why should Fargo on July 15, 1896, and again at a later date, go to him and tell him about a $10,000 note coming due on July 21st, and another on August 2d, at Metropolitan National Bank, and why should Mr.

Beale wire U. S. Rubber Company, "Extension may be refused (by the bank); Fargo promises to keep me informed, so that, if necessary, judgments can be entered on our judgment notes"?

Why should Mr. Beale advise Charles Fargo how to avoid embarrassing questions that Mr. Keith might put to him?

Is there room for doubt that from first to last Mr. Beale as a lawyer advised Charles Fargo regarding the course he should pursue at all times after making the secret January arrangement with him? At the very outset, Mr. Beale advised Fargo that it would not be safe for him to increase the Fargo & Co. indebtedness to the Metropolitan National Bank. Would he give such advice and leave Fargo in the dark as to how he should proceed with the Dixon Banks and the Merchandise creditors?

Is it not apparent from this record that the design and the only design of the January scheme was to secretly secure the L. Candee & Co. and the U. S. Rubber Company claims at the expense of other innocent and purposely deceived creditors?

Judge Grosscup, in his opinion, says (Rec., 83, 84):

> "The (January) arrangement was not intended to provide means to pay the debt, but solely to provide a legal equipment whereby the entire assets could be quickly seized, in case of disaster, and other creditors be prevented from obtaining a like advantage."

Why did Charles Fargo consult with Mr. Porter, in Mr. Beale's absence before deciding upon his deep-laid plot to get an additional $10,000 out of the Metropolitan Bank for the private use of himself and his brothers?

Fargo says (Rec., 189, 190): "That on August 5,

1896, the Fargo Co. had a note mature, for about $5,000, which they supposed was not due until the 13th; that he saw Porter about it and then telegraphed the parties for an extension, but getting no reply, the note was protested."

In this connection it is worthy of comment that no creditor has made proof in this case of a note for said sum maturing and protested on that day, and it is no more than fair to assume that the failure of Fargo & Co. on that particular day was brought about by Charles Fargo because he was ready for the crash: for this is the day when Fargo, with the assent of the Rubber Companies, went to the Metropolitan Bank and told Mr. Keith of the secret January arrangement; of the giving of the judgment notes to the Rubber Company for over $200,000, of the change in the board of directors and that Fargo & Co. was going to fail, and the Rubber Companies were going to enter up their judgments at once, and that if his bank would advance an additional $10,000 for himself and his brothers and make its claim $50,000, instead of $40,000 (Rec., 192), that he would give the bank judgment notes and see that it was let into the secret January arrangement on an equal footing with the Rubber Companies.

Judges Woods and Jenkins in their opinion say:

> "Questions of fraud in law and fraud in fact are, in their natures separate, though not always distinguishable by clearly defined lines."

If, on January 9, 1896, Fargo had not assented to the requirements of Johnson in his telegram to Beale, judgments by confession would have been entered on that day and the doors of the Fargo house closed. If by chance

knowledge of the secret scheme had leaked out and come to the ears of the creditors with whom the Fargo Co. had formerly dealt, before they had extended further credit, no leather could have been obtained on credit with which to run the Dixon factory, and the crash would have come at once and there would have been *no future creditor* as contemplated by Beale, and the provision regarding them in the agreement he drew would have availed nothing.

Charles and Frank Fargo were the sentinels constantly on duty, making almost daily reports to Beale. When there was the least intimation of danger ahead, when any creditor refused to grant an extension to Fargo as asked for, when the notes to the Metropolitan Bank were about to mature, and there was even a doubt as to whether or not they would be renewed, Charles Fargo, always on the alert lest the January bubble would burst, rushed to Beale with all the information he possessed, and then new kinds of devices were resorted to to ward off the threatened danger. Suppose early in February, 1896, within a month after the January scheme had been put in motion, that the Dixon Banks had learned that Frank Fargo had deliberately lied to them about the financial situation of the Fargo Co. and had refused his application for a loan. Is it not probable that such refusal would have been reported to Beale and would they not have decided then that their proposed scheme to rope in innocent creditors was a failure? In which case Beale would then have closed the Fargo establishment with executions issued on the confessed judgments in favor of the Rubber Companies and the Fargo Brothers would have been unable to fill their pockets beside redeeming their $15,000 of notes.

Inasmuch as Charles Fargo promptly told Beale in July that there was doubt about the Metropolitan Bank granting further extension, may we not assume that he also reported the danger he was in from Pfister & Vogel, and then later the success of the deception he had practiced on them. Suppose at any time during the spring of 1896, the Pfister & Vogel Co. had learned of the fraudulent and secret January scheme, and what five of the seven Fargo & Co. directors were placed on that board for, does any one doubt that the Pfister & Vogel Co. could on account of the deception practiced on them, have maintained replevin for such of their goods as were in the possession of the Fargo Co. when suit was brought? If so, then why may they not now be entitled to their pro rata share of the fund now in the receiver's hands, realized by the marshal from the sale of such goods?

Mr. Justice Brown, in his dissenting opinion, says:

> "The district judge (Grosscup) was of opinion that, although the giving of the judgment notes was unlawful, the arrangement by which the matter was kept secret while the corporation divested itself of power to give like notes to other creditors, and continued to carry on its business as before, rendered the whole device a constructive fraud upon its creditors. In this we all agree."

The three judges of the Court of Appeals and the district judge all agree that a fraud was perpetrated on respondents by the petitioners and they differ only as to the kind, quality or degree of the fraud committed. Is it not inequitable for a chancellor with such a record as is here presented to attempt to make such a qualification of the fraud as will permit the perpetrators of it to share with the defrauded respondents to the same extent they would have done if no fraud had been committed?

The petitioners on August 6, 1896, when they levied their executions on the Fargo & Co. stock of merchandise made no levy on the $100,000 worth of rubber goods then on hand, but without any objection from the Fargos, removed them, as though they were all of them consigned goods. It seems an injustice—outside of the fraud disclosed—that the Rubber Companies should be allowed to take back the goods they had shipped to the Fargo Co. and then levy on the goods which had been bought on credit from these respondents and others: and now the proceeds of such goods being in the hands of the receiver, we insist that it should be distributed among the respondents and other defrauded creditors from whom the goods were purchased.

If a creditor obtains a preference for the purpose of aiding his debtor to hinder and delay other creditors and for the purpose of getting security for himself, the act of preference will be regarded as fraudulent and void.

Huiskamp v. *Wagon Co.*, 121 U. S., 310.
Young v. *Clapp*, 147 Ill., 176.
Merry v. *Bostwick*, 13 Ill., 398.

In *Strohm* v. *Hayes*, 70 Ill., 41, it is held that

> "if a chattel mortgage is executed, not alone to secure an indebtedness to the mortgagee, but to protect the property of the mortgagor, and to hinder and delay his creditors, and this fact is known at the time by the mortgagee, the mortgage will be void as to the creditors attempted to be defrauded."

In *Beidler* v. *Crane*, 135 Ill., 92, it is held that,

> "although an assignment of a property right be made upon a valuable and ample consideration, without any intention to defraud any one, *yet if there be a secret trust* reserved, not disclosed by the writing, the law will treat the transaction as lacking the element of good faith, and conclusively infer fraud."

In *Phelps* v. *Curts*, 80 Ill., at p. 113, it is said:

> "A debtor, in failing circumstances, is only allowed to place his property beyond the reach of his creditors by making a general assignment of it, when he does so for the benefit of the creditors, by devoting it unreservedly to the payment of his debts, *and not with a view to his advantage* in delaying until a favorable time the appropriation of the property for such purpose."

The United States Rubber Company and L. Candee & Co. devised the January scheme, and put the Fargo Company in a position to defraud the respondents, and under the maxim that, HE WHO GAVE THE POWER TO DO THE WRONG MUST BEAR THE BURDEN OF THE CONSEQUENCES, the petitioners must make good the loss to respondents before they can participate in the fraud in controversy.

The United States Rubber Company and L. Candee & Co., had complete control over five out of the seven directors of the Fargo Company, and at all times after January 9, 1896, had absolute control of Fargo & Company's business, and it was the duty of these Rubber Companies in making purchases from respondents, on the credit of the Fargo Company, to disclose to them the true situation. Fraud may consist, as well in a *suppressio veri*, as in a *suggestio falsi*.

In *Lockridge* v. *Foster*, 4 Seam. (5 Ill.), at p. 573, the court say:

> "The contracting parties are bound to deal honestly, and act in good faith with each other. There should be a reciprocity of candor and fairness. Both should have equal knowledge concerning the subject-matter of the contract; especially ought all the facts and circumstances which are likely to influence their action, to be made known? If they have not mutally this knowledge, nor the same means of ob-

> taining it, it is incumbent on the one having the superior information, to disclose it to the other; he is bound to act in good faith, and with a strict regard to truth. If he makes false representations respecting material facts, or intentionally conceals or suppresses them, he acts fraudulently."

Where the direct and unavoidable consequence of A's act is to deceive and injure B, the law will infer an intent by A to produce that result, and this concurrence of intent and act constitutes fraud in fact upon the part of A.

In the case at bar, the unavoidable result of continuing the business of Fargo & Company after making the January arrangement, was to injure the respondents and all other creditors from whom Fargo & Company bought goods on credit. And, therefore, the law presumes that the Rubber Companies intended to commit the wrongful act.

The master and all the judges who have passed on this case, unite in condemning the transaction, as one of at least constructive fraud. And the main reason for this conclusion is, that the transaction necessarily involved, in whatever light it is viewed, a substantial deceit upon the future creditors. The logical result of this, requires a distribution of the fraud to those whose property the fund represents, before those whose acts caused them to sell the goods receive any share. To hold otherwise is to say, that courts of equity recognize the *right* of a person to obtain, by constructive fraud, goods out of which to obtain a dividend on equal terms with the person defrauded.

Whether the fraud be regarded as actual or constructive, the equities of the creditors entitle them to the pri-

ority of payment which the decision of the Court of Appeals awards.

It is a well known fact, that dishonest debtors, when about to fail, resort to many questionable devices to save something for themselves from their assets; and it is also true, that there is a class of creditors who, for the purpose of getting for themselves a preference over other creditors, resort to various questionable methods. Whenever a decision is rendered by this court, which in any way relates to the rights of failing debtors to secure favored creditors, it is carefully examined, and ingenious counsel are employed to devise new schemes for preferences which will be within the bounds of all previous decisions. And so we say, as do the majority of the Court of Appeals in the case at bar, that if this new and startling method of obtaining preferences is approved by this court, there will "be a new and fruitful motive for the creation of corporations by the many, who would be quick to avail themselves of so promising a method of pursuing hazardous enterprises at the risk of others."

Respectfully submitted.

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